A COSTLY REFUSAL TO MEDIATE

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As mediation has become the preferred way to settle or avoid lawsuits, parties to contracts have chosen to include provisions whereby they agree to mediate any disputes that may arise.

Mediation clauses are prevalent in many standard forms of agreement, and particularly in agreements for the purchase and sale of real estate. The typical agreement will contain provisions for arbitration of disputes if the parties so choose, for mediation before initiating arbitration or litigation, and for the recovery of attorneys' fees by the prevailing party.

Unlike the arbitration provision, which must be initialed by both parties in order to be binding, the mediation and attorneys fee clauses are applicable unless they are stricken. And as a recent case illustrates, the relationship between the attorneys fee clause and the mediation clause cannot be ignored.

Frei v. Davey (2004) 124 Cal.App.4th 1506, was an action for specific performance of a contract to sell real estate. The contract contained a provision for awarding attorneys fees to the prevailing party in any litigation arising out of the agreement. It also required that the parties would first mediate any disputes and that "If...any party commences an action without first attempting to resolve the matter through mediation, or refuses to mediate after a request has been made, then that party shall not be entitled to recover attorney's fees, even if they would otherwise be available to that party in any such action." (124 Cal.App.4th at 1511-1512.)

Before filing suit, the buyers made a demand to mediate, which the sellers refused. The sellers did, however, make an offer to settle the dispute by completing the sale of the property and having the real estate broker give them a credit on account of its commission of approximately $18,540. The buyers countered this offer by proposing that the commission be held in escrow and that the sellers reimburse the buyers for additional expenses of the transaction caused by the delay in closing. Negotiations broke down at this point.

The buyers sued for specific performance. The sellers prevailed and they were awarded attorneys' fees of $119,935 for trial and $37,950 on appeal. But the Court of Appeal reversed the award of fees because the sellers had refused to mediate.

The court called the case "a textbook example of why agreements for attorney fees conditioned on participation in mediation should be enforced…and a graphic illustration of a case that should have been mediated at an early stage when the parties were only $18,540 plus expenses apart in their settlement positions. Hundreds of thousands of dollars in attorney fees have been spent and the parties have litigated through two trials and three appeals. The lesson? There is a good reason the mediation

clause was in the Agreement and the legal consequences specified by the Agreement for refusing to mediate will be enforced." (124 Cal.App.4th at 1512.) "And the court further observed that "Especially given the parties' respective settlement positions and the requirements of the Agreement, the Daveys should have agreed to mediate; they did not, and are responsible for the consequences. (124 Cal.App.4th at 1515.)

The sellers argued that they had satisfied the requirement to mediate by participating in a mediation that was conducted shortly before the trial date at the request of the real estate broker. The court rejected this argument, stating that a delay of almost one year after the request for mediation was not reasonable. "The purpose of the early mediation requirement is to minimize the costs of litigation and arbitration. To allow a party to wait one year until the eve of trial to accede to a request for mediation would defeat that purpose. Of course, there is value to conducting mediations, settlement conferences or other methods of alternative dispute resolution at various stages in litigation, whether before, during, or after trial. But when a contract conditions the recovery of attorney fees on a party's willingness to participate in mediation before the litigation begins, the window for agreeing to mediate does not remain open indefinitely. The fact the mediation conducted shortly before the initial trial date was unsuccessful does not alter this analysis. Indeed, the mediation in November 2001 might have been unsuccessful precisely because, by then, the parties had invested so much money in attorney fees and their positions had become entrenched." (124 Cal.App.4th at 1517.)

Frei v. Davey is a striking example of how the winner can end up being the loser by refusing to mediate. It also illustrates the futility of litigating over a small sum of money. By the time the litigation was over, the sellers had spent more than $157,885 and the buyers had spent over $127,287 in attorneys' fees. In addition the realtor had paid its counsel $89,075 to defend a cross-complaint brought by the sellers. After an expenditure of over $500,000 in attorneys' fees, the sale of the house was not compelled, there was no recovery of damages, and the winners had forfeited their rights to recover attorneys' fees.

Mediation offers an excellent opportunity to assess the risk created by an attorneys fee clause in a written contract. Parties must always be reminded of what is at stake. The party who insists on going to trial instead of settling takes a risk that is often underestimated. Litigation is by its nature unpredictable, not only as to its outcome but also as to the time, effort and expense that will be required. It is difficult for lawyers to tell their clients in advance the amount of fees and costs that they will eventually incur for their services, let alone their potential liability for fees and costs to be incurred by the other party. Who in *Frei v. Davey* would have foreseen that a disagreement over less than $20,000 would turn into a lawsuit costing the parties approximately $500,000? And had the sellers not refused to mediate, the entire amount would have been borne by the buyers.

When clients come to mediation they will be asked to consider what their alternatives are in the event that the case does not settle. Because the alternative is

almost always a costly and time-consuming lawsuit, counsel should give their clients a litigation budget in the event that the case does not settle. In putting the budget together, it is important to emphasize that it is only an estimate and that the actual amount may vary due to factors that are outside of the lawyer's control. And if there is an attorneys fee clause, the budgeted number should probably be multiplied by two to account for the possibility that the case may be lost.

Counsel should keep in mind the words of the court: "A mediator's explanation of the process and estimate of likely expenses…could have permitted the parties, in their own self-interest, to reach a compromise agreement." (124 Cal.App.4th at 1516).

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